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Address of the President.

—AT THE—

INAUGURAL MEETING ^{OF} _{THE} INSTITUTE

—ON THE—

21st March, 1889.

TORONTO

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1889

INSTITUTE

—OF—

Chartered Accountants of Ontario.

Incorporated by Statute of Ontario, 46 Vic., Cap. 64.

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—THE—
ADDRESS OF THE PRESIDENT
AT THE INAUGURAL MEETING
—OF THE—
INSTITUTE ON 21ST MARCH, 1889

The Institute of Chartered Accountants of Ontario has now entered its sixth year since its Act of Incorporation in 1883, and I can safely state that it has steadily gained ground in public estimation, and if not so strong in numbers as could be desired, the character and standing of those who are enrolled amongst its membership, may be taken as a guarantee of its progress and importance as a public institution of Ontario.

The profession of public accountants has been recognised from an early date in Great Britain. The mention of Quilter, Ball & Co., and Torquand in London, and Harmood Banner of Liverpool, whom I knew over 30 years ago, indicates the position and standing at that time of members of that profession. It is only, however, within the last twenty years that the practising accountants of Great Britain have been organised under a charter from the Imperial Legislature, with London as their headquarters, although a similar institute had for some time existed in Scotland.

Our Ontario institute has been modelled, as far as possible, on the basis of the institute of Great Britain, but it must be remembered that, only within a comparatively recent period has there been any complete recognition of the profession in Ontario, and those practising as public accountants were not sufficient in number, to form an institute confined to their own body.

In addition to those whose names were appended to the petition for the charter of incorporation, we numbered amongst

our members a large number of gentlemen, hailing from nearly all the commercial centres of Ontario, not practising as public accountants, but acting as the accountants and financial managers of leading private firms and public institutions, who, with a laudable desire to help on the good work of obtaining our charter, gave in their adhesion to our institute, which thus in 1883 comprised amongst its membership many, who doubtless were fully competent to practise as public accountants, but who, from the nature of their duties, could have neither object nor intention of so doing. I say without hesitation that it was largely due to their support and co-operation that our Act of Incorporation was obtained from our Provincial Legislature.

I wish to lay all the more stress upon this point, because suggestions have been made in favor of narrowing down the membership of our institute, and making it a close corporation consisting only of practising public accountants. The majority of our council unhesitatingly decided that, to attempt any such action, would practically violate the condition on which we obtained our charter.

At the same time it has been increasingly felt, that the vigilance which has hitherto been exercised in the admission of new members should not be relaxed, but on the contrary, increased. All new members, before being admitted to be ballotted for, have to furnish to the council unexceptionable references, both as regards their personal character and business qualifications, but it must be clearly understood, that simple membership does not confer on any one the right to use such membership alone, as a guarantee to the public of efficiency, either as book-keeper or accountant, and for the simple reason, that our institute has under its Act of Incorporation the power of testing such qualifications by examination.

Under our charter our institute is empowered to promote and increase by all lawful ways and means the knowledge skill and proficiency of its members, and in pursuance of this object, it has held every year examinations, open to any member, whether practising as a public accountant or otherwise.

Any member can therefore apply for:—

1st A Diploma of Fellowship, enabling him to use the distinguished letters F. C. A. (Fellow of the Chartered Accountants.)

2nd. A Certificate of Competency, which is graded into:—

An ordinary Certificate of Competency.

A first class Certificate.

A first class Certificate with honors.

Although in accordance with our present constitution and by-laws, the institute has not as yet imposed upon her membership the necessity of undergoing an examination, before being admitted to the ballot; yet in order properly to carry out the object of our charter and insure to our members all the advantages to be obtained therefrom, it is most strongly recommended by the council, that an application for examination, whether for a diploma or a certificate, should be looked upon as a natural sequence to membership, and that, as a rule, those joining the institute, should lose no time in carrying out this important object intended by our charter.

Hitherto our examinations have been held once a year, but as in the case of the Law Society and other educational institutions, the number of examinations can be increased when the necessity for such increase should arise.

I have stated that *as a rule*, it is desired that all members should avail themselves of the full advantages offered by our institute, but it must not be forgotten that we are privileged to have enlisted among our membership, many gentlemen holding prominent financial positions, who, without any idea of personal advantage to themselves, have been most active and zealous in forwarding our interests, and I am sure I am expressing the cordial feeling of every member when I mention the name of the respected ex-treasurer of the City of Toronto, Mr. S. B. Harman.

As president of our institute for two years, he devoted ungrudgingly much of his time in organizing our constitution and by-laws, and to him, more than perhaps any one else, is due the successful passage of our charter through the Provincial Legislature. Both the institute and the profession generally owe him a large debt of gratitude, and we feel proud to retain his name, not only amongst our membership, but on our council, and I know that no one takes a more lively interest in our well doing. I regret very much that his health prevents his being with us to-night, and I am requested by him to express *his* sincere regret at his unavoidable absence.

I wish to call attention to our 4th by-law, enabling members outside Toronto to form local committees, and it would be

well if some advantage were taken of this privilege, which I believe, would tend to strengthen our institute and increase its sphere of usefulness. I can safely state that there is every desire to concede the benefit of "Home Rule" to such local branches, so long as their action does not conflict with our constitution and by-laws.

Although in the course of a short address it would be impossible and indeed foreign to the object which I have in view, to do more than make general remarks and suggestions, there are some points to which I wish to call attention, as coming specially within the province of an accountant's duty, in which our institute can be conducive of benefit to the community, and thus enlist on its behalf the interest and support of the financial and commercial public of Toronto and of Ontario generally.

I would particularize the question of auditing, and the nature and character of the statements submitted to public meetings, to which the signatures of auditors are appended.

AUDITING.

The value of a thoroughly efficient auditor cannot well be overrated, as the duties and responsibilities, whilst they necessarily include checking the clerical work, involve also in many cases, matters of principle, and should be the verification of all the facts set forth in the balance sheets. During my long experience as a public accountant, many cases have come to my personal notice, where it has been necessary to exercise a large discretion quite outside the mere question of book-keeping, and it would be well for all auditors to be thoroughly alive to the importance of their functions, and the more so, because the public, in some instances, do not take the trouble, and in other instances, are not competent to analyse the statements submitted at public meetings. Recent disasters have shown that institutions may publish returns which may deceive the public generally, when a concern may be rotten at the core.

In England it is the rule to entrust the work of auditing to Fellows of the Institute of Chartered Accountants of Great Britain, and practising Accountants, whilst in Toronto and Ontario generally, this employment and responsible duty, in a large majority of cases, is entrusted to gentlemen engaged

in other pursuits, and rather on the ground of personal interest with members of a board, than of personal fitness for the duties.

Whilst I would not wish to question in the least degree the efficiency of any of the auditors whose names are appended to the balance sheets of our large monetary institutions, I think it is to be regretted that, when there is an Institute of Accountants empowered under a special Act of Parliament to test by examination the competency of parties doing accountant work, and give public testimony of the same under its hand and seal, so many (whatever may be their other duties) who act as public accountants in so far as they undertake work peculiar to that profession should hesitate to join an institute which would enable them to bring their ability to the test of examination. In the matter of municipal accounts it has been suggested that all auditors of such accounts should graduate at an Institute of Accountants, and it is a question worthy of consideration, whether persons undertaking the duties of auditing generally, should not possess at least a certificate of competency.

I would go further, although I may be considered premature in this expression of my opinion, and ask whether the duties of a public accountant are not of sufficient importance, and the necessity of insuring the necessary qualification for the performance of such duties so essential, that some guarantee should be provided by the Legislature, as in the case of legal and other professions, obliging persons practising or intending to practise as public accountants, to graduate at an institute recognised by Act of Parliament.

BALANCE SHEETS.

Balance sheets as presented at public meetings, are intended to place shareholders in possession of a statement of the profits of the current year, and of the general resources of the company in which they hold stock. These important documents, of which the essential element should be perfect clearness and perspicuity are presented under such varied forms, that the general body of shareholders, more or less inexperienced in matters of account, have, as a rule, no alternative

but to accept reports as submitted, and possibly pass a report with the accompanying statements as favorable, where a skilled analyser might find occasion to take exception on points which might otherwise escape observation.

This is all the more important, because the value of shares as quoted in the stock exchange, is often very misleading, and there are influences which operate to effect the rise and fall of stocks, independent of their real legislative value. I might instance the case of the Federal Bank, which was quoted greatly above par shortly before its collapse, when its subsequent history revealed that its rest was gone, and its capital impaired.

As a rule only two statements are indispensable.

1st. A revenue, or profit and loss account, showing the gross earnings of the current year, the expenses of management being deducted and any charges incident to the special character of the business.

2nd. A balance sheet, or statement of assets and liabilities, in a clear and succinct form, defining clearly between the liabilities to the public and the liabilities to the shareholders, the latter including the share capital, the rest, or surplus assets, and the revenue of the current year.

These two necessary documents apply generally to every description of balance sheets. In the case of trading and manufacturing companies the character of the revenue account will necessarily vary with the nature of the business.

There are, however, certain points, which I think, come within the province of an auditor, and which should be borne in mind.

1st. The proper value of the stock in trade and the factors which should enter into the value. The important point is that it be taken at cost, which in the case of purchased goods includes, in addition to the cost at the place of production, all such expenses as freight, duties, insurance, and the like, and in the case of manufacturing, the wages and all expenses incident to the manufacture; and whilst on this point, it is clear that no rise in value during the course of the current year on goods in stock should form an element of profit.

The profit of the year is not an *expectant* but a *realized* profit, and however the value of any article, be it produce or otherwise, may have increased, until it has been *assured* by actual sale, it should not be taken into account as revenue, still less applied to payment of dividend. If any special enhancement of the value of the stock on hand at the time of striking the balance has taken place, it might be referred to in the report, but should not be included in the statements.

2nd. The necessity of setting aside out of the year's revenue a provision for bad debts, and in addition to this, in concerns where capital is invested in plant and machinery, a certain percentage for wear and tear and depreciation.

I have mentioned the cost of goods as the basis of value, but whilst the stock should never be valued *above cost*, yet in certain branches of trade, where goods are materially depreciated owing to change of styles or similar causes, they should be carried forward at such reduced value.

Whilst on this subject, I believe it would lead to advantageous results, if an audit similar to the audit required in the case of public companies were extended to private concerns, and the accounts of such concerns, if not regularly, at least occasionally, submitted to a professional accountant outside the regular staff, more especially in reference to the final adjustments of the accounts, and the relative interests of the members of a firm.

I can speak through personal knowledge, of firms who have been well rated and have enjoyed extensive credit, where financial trouble might have been averted, had properly prepared balance sheets, based upon correct stock staking, and valuation of assets been regularly prepared and audited, and the real position of affairs ascertained in time to ward off disaster.

I believe if this suggestion were carried out, it would result in greater care being taken by those to whom the book-keeping is intrusted, and often in the adoption of better systems of accounts.

LOAN SOCIETIES.

In loan societies the assets are practically limited to loans on first mortgage on real estate, and in some instances to the buildings in which the business is transacted.

The item of real estate vested in a company either by foreclosure or under the power of sale in the mortgage is one more honored by its absence than its presence. In the returns made to government, all particulars under this head have to be furnished, and in some companies whenever any properties come into the hands of the company, the practise is to show them in the balance sheet, under the head of real estate, as distinguished from loans on first mortgage on which no question can arise as to the validity of the security, I am inclined to give the preference to a course which by placing these transactions on record in the balance sheets puts the shareholder in full possession of all the facts.

I do not attach much importance to the practise of furnishing elaborate statements of cash receipts and expenditure. I have known cases where the information given to shareholders has been narrowed down to these cash statements, when a skilled accountant with the assistance of the last year's statement might with difficulty glean some idea of the result of the business of the current year.

BANKS.

In the case of banks, the officials do the work, which in other institutions is performed by outside auditors, although recent bank disasters are evidence that the public can be deceived by statements, which the result has shown to be utterly unreliable.

The largest portion of the assets of a bank are of such a character, that it would be practically impossible for any but those connected therewith to form any correct estimate of their value.

It would be therefore useless (as has been found in the case of American banks) to institute any system of outside audit which would extend no further than an enquiry into general results and the extent to which a bank is complying with the requirements of the Law.

INSURANCE ACCOUNTS.

In the matter of insurance accounts there is one important element that should be clearly shown, viz., the question of liability.

In the province of life insurance the rates of premium are based upon ascertained tables of mortality, so that the question of liability is one which can be arrived at with a certain degree of accuracy, as contrasted with the element of uncertainty which exists in other departments of insurance business.

By taking into consideration

1st. The duration of a company's existence.

2nd. The income derived from premium.

3rd The accumulations of premium.

The status of a company can be arrived at without much danger of misconception.

In the matter of marine insurance, as regards our inland waters, with the exception of a few annual risks on hulls, the liability practically ceases with the close of the navigation, and I am much mistaken if the experience of Ontario companies has not proved that at such a distance from the sea-board, insurances on salt water risks cannot be undertaken except at considerable disadvantage.

As regards ocean marine risks on hulls, it is almost impossible to approximate to the liability which may attach under a contract for a time policy.

In the matter of fire insurance, policies are effected for a definite period, during which term the liability attaches.

An annual policy, for instance, dated on the 1st July, extends to a similar date in the following year, so that it is evident that if the accounts are made up to the 31st December, a liability attaches for six months after that date. It follows therefore, that where the business has been uniformly spread over the whole year, all annual risks taken after the commencement of the current year are in force for a longer or shorter period in the ensuing year, or an average of six months, and this average has been taken as the basis on which to calculate the insurance reserve or unearned premiums required by government.

In estimating the revenue of an insurance company, the following are necessary elements for a correct statement :

1st The gross premium income less reinsurance.

2nd The necessary expenses incident to obtain this income.

3rd The losses, attaching to the premium income of the current year (as distinct from losses attaching to the premium income of the preceeding year.)

4th The necessary insurance reserve to cover the risk on the unearned portion of the premium income of the current year.

The balance will be applicable to dividend and rest.

In an insurance balance sheet it is hardly correct to use the term "profit and loss," as although the rates of premium are calculated upon a certain average of risk, yet there are exceptional events, which may baffle all calculation.

In estimating the liability on the unearned premium income, the government standard has been assumed on the basis of 50 per cent. of the gross premium income.

I must express an opinion that this percentage is too large, because it must be taken into consideration, that the premium to produce a *fair return* for the assumed hazard has to be reduced by the cost of obtaining the business, amounting on an average to upwards of 30 per cent, so that the actual income which a company handles is not more than 70 per cent or thereabouts of the gross premium.

It would therefore appear in my view of the case manifestly unfair, to charge such a percentage on the gross income, which, taking the *cost* of the business into consideration, leaves only a balance of 20 per cent. to cover all losses ascertained to the close of the current year on the policies attaching to that period.

Would it be fair to a merchant, to carry over his stock simply at its cost at the place of production, and to charge the expenses of bringing his goods to market (such as freight, duties, ect.) to the current year, and then say he is insolvent because his business under such circumstances may show a deficiency.

In the case of large English companies in some instances based upon the experience of a century, the equitable practice has been to estimate the reserve on the net income and making a small allowance for profit, carry over 50 per cent.

of the balance to meet the liability on unearned premium, or say about $33\frac{1}{3}$ per cent. of the gross income.

On the other hand I think that in the balance sheets as submitted by our Canadian companies, there is often an absence of that clearness and perspicuity which should characterize statements of such importance.

In companies doing business in different branches of insurance, such as fire and marine, it is manifestly incorrect to group together either the premium or losses. As far as possible, each branch should be kept perfectly distinct, so that the relative profit or loss on each department could be clearly shown from the annual statement.

The ordinary plan of presenting to shareholders, the results of insurance business is simply to take the gross premium, less the reinsurance adding any interest on investments, and then charging on the other side the expenses and ascertained losses of the year, treat the balance as profit. The insurance liability is not taken into account, as a factor affecting the revenue of the current year, but if imported into the balance sheet, is treated as a charge against the surplus assets of the Company.

I think the sound principle is to show the results of each year's business by taking this insurance reserve out of the year's income on the same principle that in a trading business, a reserve should be set aside out of the year's revenue to cover liabilities on bad debts, on such debts as are due to the Company at the close of the current year, and are carried forward amongst the assets.

The principle of charging to the current year the losses only which attach to policies effected during that period, as distinguished from losses on the unearned premium of the preceding year, would enable a shareholder to see clearly the real position of the business and the true annual results.

It could be seen if the reserve of the preceding year was sufficient to cover the loss attaching thereto and especially set aside for that purpose, or if it would be necessary to encroach upon the surplus of previous years (if any) or the revenue of the current year to meet a deficiency if it should arise; and it would clearly indicate whether a dividend was paid out of the legitimate income of the year, or out of the surplus assets of a Company, which had been, or should have been set aside for other purposes.

In making these remarks, I wish especially to call attention to the advantage to be derived from the combined judgment and experience of a body of men, skilled in accounts, and conversant with insurance business in framing a form of balance sheet to be uniformly adopted by Insurance Companies, which would enable shareholders intelligently to examine for themselves the real position of the business, and the actual revenue and resources of Companies in which they have invested their money.

I am anxious to call special attention to the fact that in connection with our Institute, a Board of Adjusters has been organized to take hold of the adjustment of claims, and more especially when questions of difference may arise.

In such cases, I would submit that both Insurance Companies and insurers would find it an advantage to present such claims to the consideration of an independent Board, whose only object and interest would be to give an impartial verdict, fair to all parties.

During the past year cases were submitted to this Board, and claims settled on the basis of their adjustment.

COURTS OF LAW.

In the event which not unfrequently happens of disputed matters of account coming before our Courts, the Institute furnishes a tribunal to which such questions could be submitted, which would be outside the province, and in most cases the capacity of a jury to decide.

Whilst on this point, I would remark that the profession of Accountants should be recognised in our Courts, and when subpoenaed to give evidence, should be entitled to professional fees.

Before closing this address I think the thanks of the Institute are due to those gentlemen who have contributed papers which have been read at our monthly meetings.

These papers have been

By Mr. John Hague, on Foreign Exchanges.

“ J. M. Martin, on Auditing.

“ J. H. Menzies, on Banking.

“ Wm. Powis, on Municipal Accounts.

Arrangements are in progress for papers to be read in the ensuing season, and I earnestly press upon the members of our Institute to make a point of attending, as far as possible, these meetings. It seems unfair when gentlemen have taken both time and labor to prepare interesting papers, to find, as too often has been the case, only a meagre attendance on the part of those who should give their cordial support and co-operations.

I wish also to state at our monthly meetings we desire to tender a cordial invitation to the general commercial and financial public, not only to be present, but to take part in our discussion.

I trust that our Institute will be carried on in such a manner that we may command the support of the business community of this important City, and of the Province of Ontario.

HENRY W. EDDIS,

PRESIDENT.

